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JACEK JAWORSKI

Challenges of Corporate Financial Management

Høgskolen i Hedmark

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Sammendrag:
Den finansielle styringen av et moderne foretak er i noen grad sammensatt. I bidraget har en et fokus på grunnleggende utfordringer, og tilnærminger til disse, som leder i retning av at mål blir nådd på en effektiv og rasjonell måte.

Bidraget innledes med noen perspektiver på den finansielle styringen, og sett i forhold til elementer og områder. I tillegg har vi spørsmålet om hva de finansielle målene bør gå ut på. Mer konkret ser en på hva oppstillinger i finansregnskapet har å bidra med som kilde til informasjon om den finansielle situasjon. Det er klart at et foretak må arbeide med en sammensetning av eiendeler og forpliktelser (egenkapital og gjeld) som er formålstjenelig. Dette innbefatter styringen av omløpsmidler, som blir fokusert avslutningsvis.

Hedmark University College

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Summary:
The main goal of the paper is to present the fundamental rules and problems of corporate financial management in the context of proficient and effective achievement of financial objectives.

The first part of the paper explains the concept of corporate finance, describes its components and defines the main areas of financial management. The second part is devoted to the financial objectives of the company. The next section provides a brief description of the financial statements as a source of information about the company's financial condition. The last two parts include issues related to shaping the structure of assets and liabilities and to working capital management.

Preface

Nowadays, the success of the enterprise largely depends on effective management. Dynamic changes in the economic conditions in XXI century economy is the reason for that the modern enterprise has to make faster and smarter decisions while wanting to achieve their objectives.

In general, management consists of setting the objectives and causing them to achieve [Lichtarski, 1999]. Thus, the management process involves: identifying options, goal setting, and then the appropriate shifting and transforming the resources of the enterprise in proper directions. R.W. Griffin [2006] defines the management as a set of activities involving planning and decision making, organizing and leading (leading men and controlling) directed to the resources (human, financial, material and information), performed with the intention of achieving the business objectives in proficient and effective ways. «Proficient» means using resources wisely and without unnecessary waste, and «effective» means operating successfully.

The main goal of the paper is to present the main challenges, rules and problems of corporate financial management in the context of proficient and effective achievement of financial objectives. The financial management is presented from a normative point of view.

The author of this paper is assistant professor at the Gdansk School of Banking (Accounting Department) in Poland, and holds a PhD degree. The research offered is mainly based on the analysis of contemporary literature, and the author's own reflections. On this basis, ideas on how to manage the finances of companies in a modern economy are developed. Special attention has been dedicated to companies operating under the Polish legal system. In Autumn 2010, in visting Hedmark University College (Campus Rena), the paper of the author was presented.

CONTENTS

SECTION 1

Main Categories in Financial Management

Corporate finance consists of all economic phenomena related to acquisition, collection and disposing of funds for a business purpose. This is also a combination of processes mainly used to control the capital of the company [Bień, 2005]. Thus, the financial management in the enterprise includes making decisions about shaping the flows of means to achieve particular financial objectives of the company. Diagram 1 presents the main relations between these fundamental categories.

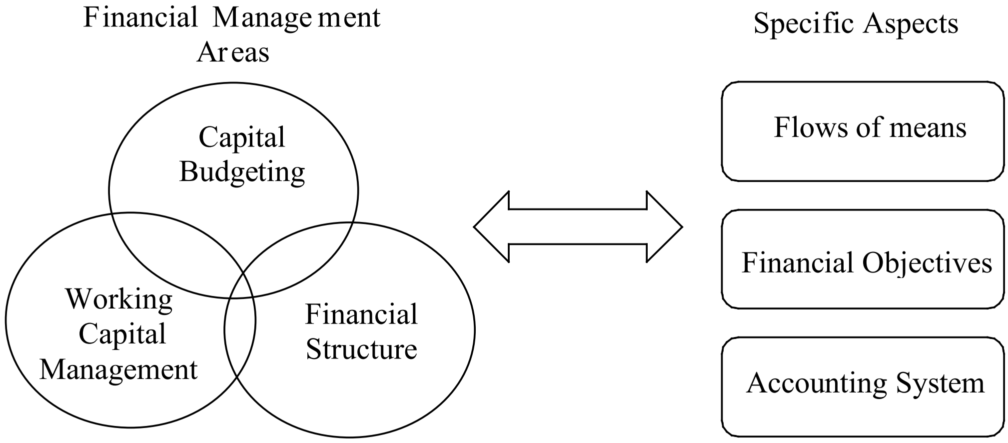

Diagram 1. Financial flows, objectives and management areas in the enterprise (Source: Own elaboration)

The essence of money is its ability to quick transposition to the other assets of the company. Money allows to buy: labor (employees), material resources (buildings, machinery, stocks etc.) and knowledge (technology). But money does not constitute a strict sense of a business purpose or an effect of its activity. It shall be used to build the structure of assets and to pay bills. Corporate finance should be seen primarily in dynamic terms, as streams of moving and changing resources. Fundamental cash flows are presented in Diagram 2.

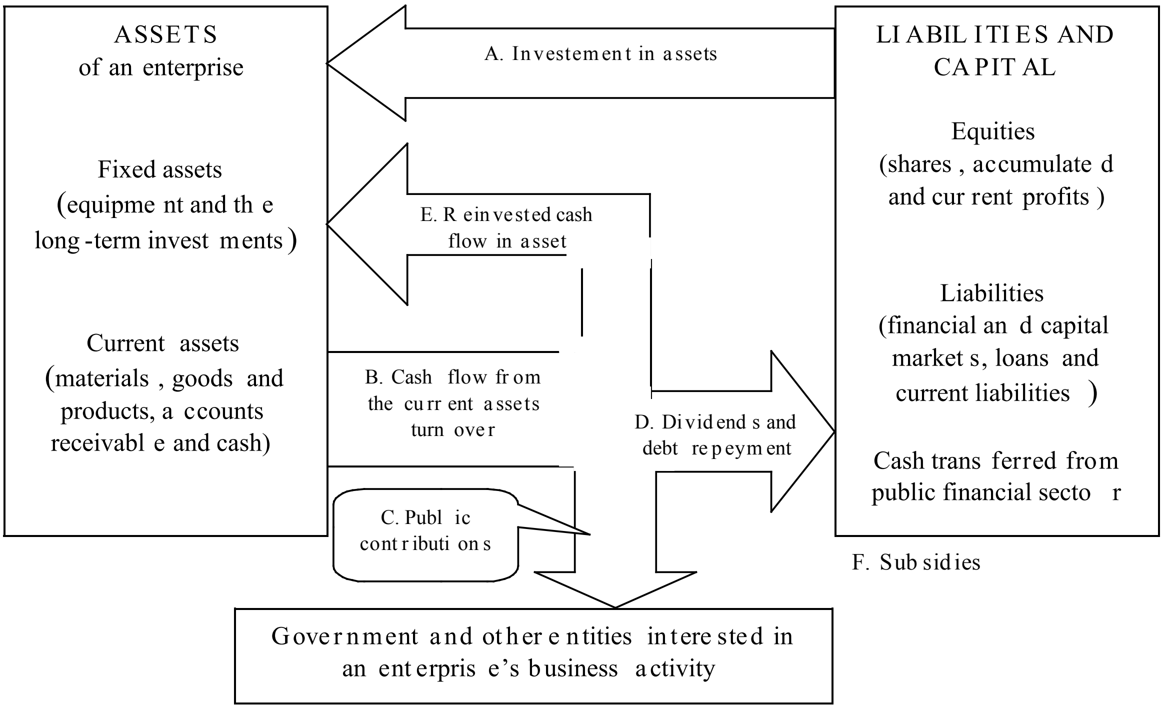

Diagram 2. Fundamental cash flow in an enterprise (Source: Ross, Westerfield and Jordan, 1998)

To accomplish its objectives, a company should firstly have suitable assets. These as-sets should allow a company to implement the assumed activities, i.e. the quantity and quality of machinery, and the place and methods of their use must be suitable for the particular size of the business. This should also include materials, receivables and cash. This area of decision is called a capital budgeting. Assets can be divided into fixed and current. The first group comprises equipment and long-term investments, while the second consist of materials, goods and products, accounts receivable and cash.

Another area of financial decisions often made at the same time as above, is that of getting access to sufficient cash for buying planned assets (A). The primary source of these funds, are typically cash and assets from the owners of the company (equity). Unfortunately, as practice shows, in the SME sector, equities usually allow management only to acquire a small quantity of assets. Thus, other funds are necessarily acquired from market participants such as suppliers, banks, external investors etc. In this way, a company takes its first liabilities. The area of decisions such as «how much and where to incur debts», is known as a construction of the financial structure.

The source of additional free cash flows generated in the enterprise leads to current assets rotation. Diagram 3 shows the basic components of operating assets, as well as their transformation.

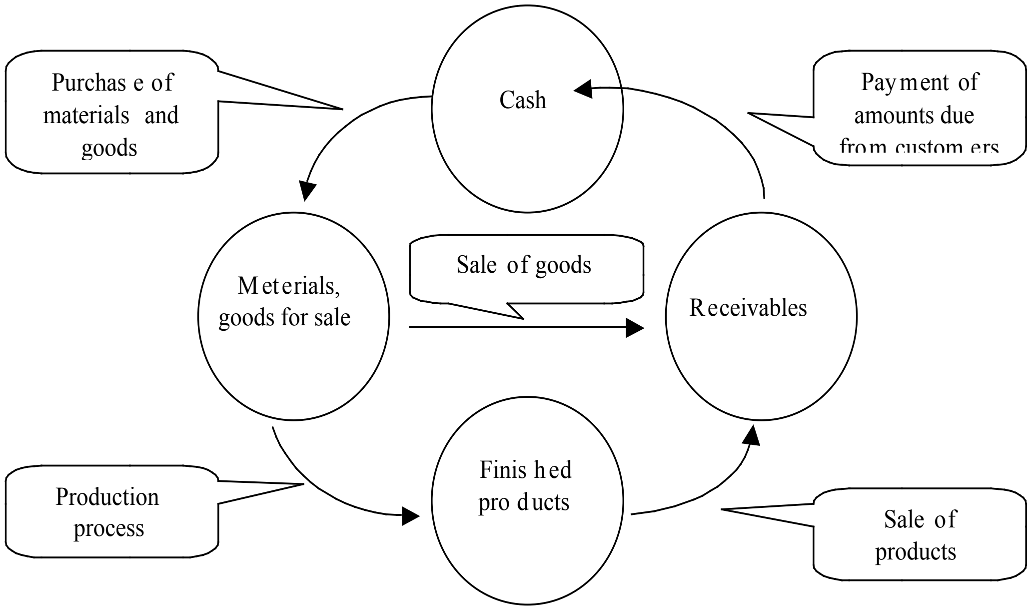

Diagram 3. Transformation of current assets (Source: Jaworski, 2009)

Making purchases of materials and goods causes cash spending. In this process, one of the components of current assets (cash) turns into any other component (stocks). Within a short period, which, as a rule, a company tries to reduce even further, materials are used to create finished products. In turn, goods for sale, as the name suggests, are subject to the immediate sale process without further processing. After the completion of the technological process, products are sold, too. In this way, there is the next change of assets – stocks turn into receivables. The last component of the current assets replacement is changing receivables into cash at the moment of customer payment.

During current assets turnover, the company aims to produce added value. Added value is expressed as surplus of income from sold goods and products over the expenditure related with the purchase of materials and production costs. Most often it manifests itself in imposing the gross margin by a company (the difference between the price of purchasing the necessary materials (goods) and the selling price of the finished products). Faster turnover of assets increases the chance that the profit margin will be larger. From this margin, the company pays all other costs related to the operations (wages, rents, services, currencies). Afterwards, the cash flow marked in Diagram 2 by the letter B is generated.

Some entities in the environment of the enterprise submit claims on company profits. The first one is the government (state and local). It collects fees from the enterprise, so-called public contributions (stream C in Diagram 2). The essence of the public sector revenue is to meet the needs of society, in which the company operates.

Subsequently, the company is required to satisfy its creditors. Such claims arise from previous commitments. Summing up – during the construction of financial structure (gathering the resources needed to finance the proposed assets), the company has borrowed parts of what is needed from other market participants (banks, other businesses, etc.). Thus, commitments arise from contracts signed with third parties. Cash flow for liabilities payment is indicated in Diagram 2 by letter D.

The same letter indicates the next cash flow, reducing added value created by current asset turnover. It is cash flow belonging company's owners - dividends. The owners guarantee that a company exists and works. By bringing their contributions to the company, they bear a greater risk associated with that of the failure of the business. Thus, they expect the largest benefits in case of positive outcomes. This means that after repayment to creditors, the company must share the generated cash flow (profit) with their owners (of course if the owners want it). Only the rest of these funds may constitute an additional source of funding the company's assets. This is indicated in Diagram 1 by letter E.

In this flow of means, what is also called free cash flow (FCF), is one of the key categories that will allow the enterprise to grow. It is a major source of self-financing, it increases the debt capacity of the enterprise and its credit rating. Therefore, it is a very important factor in shaping the development of the company, which creation is of main interest of every company. Thus, its maximization is one of the main financial objec-tives of the company. In this context, the issue of creating FCF will be discussed in the next section of the paper.

To sum up, the discussion of cash flows in the enterprise, the increasing share of subsidies in corporate financing (letter F in Diagram 2) should also be noted. Especially, this is relevant for EU countries. The EU supports the business sector organizationally and financially in achieving its main objectives. Assistance programs based on the EU budget, being the result of an explicit policy, allow companies to obtain additional sources of financing for investing, improving workers' skills and qualifications.

The financial decision area concerning determining current assets levels, organizing their turnover and paying the bills is called working capital management. This is the third and sometimes the most important kind of decisions [Jaworski, 2009; Ross, Westerfield and Jordan, 1998].

SECTION 2

Financial Objectives of the Enterprise

The effectiveness of financial management depends, inter alia, on the skilful de-termination of appropriate financial objectives. In classical economics, the main financial goal of the en-terprise is to maximize profit [Begg, Fisher and Dornbusch, 1998]. Many authors [i.a. Czekaj and Dressler, 1996] criticize this point of view in taking into consideration two of its major disadvantages:

- 1) Profit maximization may only take place under circumstances of reduced risk.
- 2) Profit maximization is only possible over a shorter time horizon.

So, currently, to maintain company's performance, profit is less important than the actual cash flow [Urbańczyk, 2003]. Increasingly, it is said that the cash is a fact, the profit is only the opinion [Black, Wright and Bachman, 2000; Brilman, 2002]. This claim is confirmed by facts: 70 % of bankrupt companies in the U.S., are due to the lack of cash, despite their increasing profits [Jabłoński, 2002].

In 1951, J. Delan published an article in which he wrote: «The fundamental assumption of economic theory that the primary goal of every company is to maximize profits, has been bankrupted. Theorists have realized that many companies, especially large ones, no longer work on the principle of profit maximization in terms of marginal utility accounts. It is necessary to refer this principle, rather to long-term accounts, where the profit relates primarily to the revenues of the owners and management and also it includes non-monetary benefits such as free time or more pleasant relationship between different levels of management in the company». This does not mean that profits and profitability are invalid. But it proves that they are not the main goals of the company, and even, sometimes under certain conditions, they are limiting factors for achieving these goals [Drucker, 2005].

S.A. Ross, R.W. Westerfield and N.A. Jordan [1998] define the management's objective as follows: «if we assume that shareholders buy company stock, because they want to gain financially, it is a good decision to increase the value of the purchased shares». Therefore, the main financial aim of the company is increasing the wealth of the owners by maximizing the value of the company.

H. Davies [1991] combines neoclassical objectives (maximizing profits) with a modern approach to maximizing the value of the company, showing that seen in a long-term policy perspective, the first of can be translated into growth of revenue for the owner. Profit means in this case the economic returns, consisting of classical accounting profit and opportunity costs. Studies in this direction show that the maximization of profits is therefore not a goal, but the tool widening owners' benefits. From this point of view, maximization of the company value is the principal, the long-term financial goal. But this value is not only a book valuation of assets or income. It also includes non-cash elements such as market position, ability to raise capital etc. However, it is underlined that the maximization of company value is related to an increased effectiveness of the various areas of management (including financial management) [Szyszko, 2000; Szczepankowski, 2007]

The efficiency of financial management is manifested mainly in maximizing the cash profitability of equity. The cash profitability means the generation of positive and free operating cash flows. If these flows are increasing, the possibility of a self-financing enterprise is established. The primary measure of these flows is the financial surplus. It is the sum of the two principal sources of additional cash flow: the accounting profit, and costs which do not generate cash spending – depreciation [Bień, 2005; Ross, Westerfield and Jordan, 1998].

In conclusion, the conceptual approach to maximize the benefits of the enterprise owners includes the activities consisting of the implementation of operational financial objectives. They can be divided into [Jaworski, 2010]:

- 1) Short-term goals – to achieve the assumed profits.
- 2) Medium-term goals – to obtain additional free cash flow.
- 3) Long-term goals – to increase the market value of the company.

Section 3

Sources of Financial Information

The main source of information needed for financial management is bookkeeping. Financial managers use detailed accounts, and of course, their outcome – financial statements. On this basis they decide, for example, about the investment in assets and the raising of loans. These sources are also used in cash management.

The accounting obligations of Polish enterprises are included in the Accounting Act [AaA]. In accordance with this law, Polish enterprises are divided into:

- 1) Natural persons and their companies, whose revenue within the last year did not reach € 1 200 000.
- 2) The rest, natural and all legal persons.

The first group can use simplified tax filing systems. The second has to follow standards of financial accounting. The attachments to the Accounting Act contain legal standards for financial statements for all enterprises. Mandatory elements of financial statements for all entities are:

- 1) Balance sheet (Table 1)
- 2) Income statement (profit and loss/P&L statement) (Table 2)
- 3) Notes to financial statements

The balance sheet is divided into two parts: assets and liabilities + equities. Assets are what a company uses to operate its business, whereas its liabilities and equity are two sources that support these assets [Jaworski, 2009].

Assets	X-1 year	X year
A. Fixed assets	680,7	440,9
I. Intangible Assets	0,0	0,0
II. Tangible assets	680,7	440,9
III. Long-term accounts receivable	0,0	0,0
IV. Long-term investments	0,0	0,0
V. Long-term prepayments	0,0	0,0
B. Current assets	5 330,5	2 367,9
I. Inventory	2 096,7	885,5
II. Current accounts receivable	2 349,0	1 171,6
III. Cash and cash equivalents	873,2	287,0
IV. Prepaid expenses	11,6	23,8
TOTAL ASSETS	6 011,2	2 808,8

Liabilities and Capital	X-1 year	X year
A. Equities	1 196,9	1 326,5
I. Authorized shares	500,0	500,0
II. Collectible owner's payments (-)	0,0	0,0
III. Own stocks and shares	0,0	0,0
IV. Legal reserve	436,4	696,9
V. Revaluation reserve	0,0	0,0
VI. Other reserve capital	0,0	0,0
VII. Retained earnings	0,0	0,0
VIII. Net profit	260,5	129,6
IX. Net profit write-down (-)	0,0	0,0
B. Liabilities and provisions	4 814,3	1 482,3
I. Provisions	0,0	0,0
II. Long-term debts	133,6	0,0
III. Current liabilities	4 680,7	1 446,3
IV. Unearned revenues and deferred liabilities	0,0	36,0
TOTAL LIABILITIES AND CAPITAL	6 011,2	2 808,8

Table 1. Typical balance sheet in Poland (Source: Jaworski, 2009)

Current assets have a life span of one year or less, meaning they are easily converted into cash. Classes of such assets are: cash and cash equivalents, accounts receivable and inventory. Cash, the most fundamental element of current assets, also include non-restricted bank accounts and checks. Cash equivalents are very safe assets that immediately can be converted into cash. Accounts receivable consist of the short-term obligations owed to the company by its clients. Lastly, inventory represents raw materials, work-in-progress goods and the company's finished goods.

Fixed assets are assets that are not easily turned into cash, and are expected to be turned into cash within a year and/or have a life-span of over a year. They are tangible assets (such as machinery, computers, buildings and land), intangible assets (such as goodwill, patents or copyright), and financial fixed assets (such as prepayments, accounts receivable).

Equity consist of funds contributed by the company owners, and funds earned by the company. The first group includes: authorized shares and other reserves. Other items (mainly profits, earnings and legal reserves) belong to earned capital.

Liabilities are also divided into two main groups, that is short and long term debt. The first of them mainly includes the results of trade payables, wages, taxes and other settlements. The second group of debts, first of all, consists of bank loans. The provisions are a special group – these are predicted liabilities, which will become debt in a specified period.

In accordance with AaA, the company's management can choose one of two income statement forms:

- 1) Multiple-step form – costs of a basic activity are arranged by their space formation after product costs' calculation.

- 2) Comparative (single-step) form – contains all kinds of costs; costs of goods left in stock and their influence on products' change.

For drawing up the first form, AaA provides a cost statement according to their kinds in the notes to the financial statement. Therefore, the second form is mostly chosen (see Table 2).

Items	X-1 yr.	X yr.
A. Sales revenue	30 151,0	24 306,0
I. Sales of products and services	3 087,0	3 326,0
II. Changes in finished products' stock	0,0	0,0
III. Cost of products made for own requirement	0,0	0,0
IV. Sales of goods and materials	27 064,0	20 980,0
B. Operating expenses	29 932,0	24 013,0
I. Depreciation	281,0	283,0
II. Materials and energy wear	130,0	300,2
III. External services	1 577,0	1 102,0
V. Salaries	3 826,0	3 867,0
VI. Social insurance	980,0	946,0
VII. Other overhead cost	751,0	514,0
VIII. Cost of goods sold	22 387,0	16 999,0
C. Sales income/loss	219,0	293,0

Continued next page .....

D. Other operating revenue	9,0	12,0
I. Income from tangible assets sold	0,0	0,0
II. Subsidies	0,0	0,0
III. Other revenue	9,0	12,0
E. Other operating costs	12,0	168,0
I. Loss from tangible assets sold	0,0	0,0
II. Revaluation of non-financial fixed assets	0,0	0,0
III. Other costs	12,0	168,0
E. Net operating income/loss	216,0	137,0
G. Financial revenue	190,0	65,0
I. Dividends	0,0	0,0
II. Interests received	190,0	65,0
III. Income from investments sold	0,0	0,0
IV. Revaluation of investments	0,0	0,0
V. Other	0,0	0,0
H. Financial costs	66,0	14,0
I. Interests paid	66,0	14,0
II. Loss from investments sold	0,0	0,0
III. Revaluation of investments	0,0	0,0
IV. Other	0,0	0,0
I. Income/loss of business activity	340,0	188,0
J. Extraordinary performances	0,0	0,0
I. Extraordinary income	0,0	0,0
II. Extraordinary losses	0,0	0,0
K. Gross profit/loss	340,0	188,0
L. Income tax	79,0	58,0
M. Other obligatory expenses	0,0	0,0
N. Net profit/loss	261,0	130,0

Table 2. Typical P&L in Polish small enterprises (Source: Jaworski, 2009)

Polish P&L consists of five parts [Jaworski, 2009]. The basic business activity is described in the first part. The second part concerns other operating activities, and that means all dealings and accounting operations only implicitly linked to the core business. Financial decisions and their effects are presented in the fourth part. The last part concerns extraordinary performance, mainly linked to random events. In each part revenues and costs are presented separately.

Section 4

Assumptions of the Capital Budgeting and Financial Structure

The main domain of capital budgeting is to set the investment policy in fixed assets. This policy's formulation is the essential element of the strategy building and it is a precondition for the development of the modern enterprise. Its key assumptions and directions are a consequence of analysis and strategic planning. The conditions and ways of investment, including in terms of implementation, are different for financial and tangible investments.

The main differences arise from strategic business objectives. The latter (tangible investments) are related with the circulation of goods and services in the economy, so as to the real manifestations of resources transformation. The asset allocation in banks, investment funds or other capital investments is not a subject of the investment policy of enterprises. Companies mostly use this investment direction for funds, which for the moment they do not see a use in the core business. Such funds may also be used as an alternative form of temporary cash "holding", periodically released from the core business. In both cases, the basic aim of investing is to avoid the cost of keeping cash in the company and to extract benefits from the capital market [Jaworski, 2010].

Most companies seek their further development in investing in expansion and modernization of the business (tangible investment). E.F. Brigham [1997], taking into account the experience of U.S. companies, has distinguished the following major conditions for this sort of investment:

- support of existing activities – these are funding and replacement investments, which serve to maintain proper production, service and trade capacity,
- reduce costs – investment projects leading to modernization of economic assets, which guarantee savings on labor costs, materials, raw materials, etc.,
- development of existing products or markets – investments that are directed at the intensification of production and current market expansion,
- expansion into new products or markets – investment projects that are a consequence of the strategic decision to expand the product range or territorial activity,
- improving safety and environmental protection – these projects usually are the result of procedural requirements, hence they are often seen as a compulsory investment expenditure.

Conditions mentioned should be complemented in collecting more data, in more efficient processing and by transparent presentations. Of course, this leads to an increasing investment in research and development activities [Jaworski, 2010].

A characteristic feature of all types of investments is the need to incur, in the initial period, high investment. Afterward, relatively small but regular benefits are obtained in the long run. The initial capital incurred for the implementation of investment projects is determined on the basis of accessible information. That is, information contained in technical market studies, business plans and other documents related to the estimation of investment costs. The forecast of cash inflows should be the result of market research such as the study of demand, of price level and also of project lifetime.

Cash flows in subsequent years of the investment can be defined on the basis of expenses and cash receipts. These flows result from a comparison of revenues and expenditures. If revenues are higher, then the flow spending is positive. If not, the flow becomes negative. Value, direction and dynamics of changes in cash flows during the investment are a subject to assessing the profitability of the project. In the accounts of the profitability of the investment, kinds and cost of capital used in the project will have to be taken into consideration [Jaworski, 2010; Bień, 2005; Szyszko, 2000].

Self-financing has strictly defined limits. The company may regulate the amount of profit by raising or lowering the net profitability of their activity. It can also use manipulations of depreciation of fixed assets permitted by law. However, the level of a financial surplus is limited by capabilities and potentials of the company, its innovation and environmental considerations.

Another way of financing by equity is to attract new owners – shareholders. J. Bednarz and E. Gostomski [2006] mention following external sources of equity:

- 1) In a limited liability company: (i) New shares or an increase of existing shares brought by shareholders in cash or in tangible contributions, (ii) subsidies made by shareholders, or (iii) loans from the owners for future shares.

- 2) In a public limited company: (i) Shares paid in cash, tangible contributions or declaration installment payments, (ii) net profit used to cover the redemption of shares, (iii) issuance of new shares, (iv) change ownership of registered shares, or (v) increase of share capital by converting a limited liability company to public limited company.

Although the company may increase the share of equity capital in assets financing, it usually is forced to use a foreign capital. The foreign capital is provided by a creditor for a limited time after which it must be returned. Using this type of financing is usually results in incurring costs in the form of interest. Borrowed equity can rarely be used for any purpose. Typically, the creditor must approve the purchase of determined assets. He can also control the financial condition of the company. He does it given an estimate of the risk level related to the agreed way of financing [Bednarz, Gostomski, 2006].

Foreign capital is divided to short- and long-term. Table 3 presents typical sources of foreign capital.

Long-term	*Short-term*
• provision • long-term bank loans and credit guarantees • leasing • franchising • bonds • donations	• trade credits • short-term bank loans • factoring • loans from other persons • short-term debt securities

Table 3. Typical sources of foreign capital (Source: Bednarz and Gostomski, 2006; Jaworski, 2010)

Under Polish conditions, the most popular source of foreign financing is a bank loan. Companies use it mainly in long-term financing, but also for short-term ones it has a significant position of liabilities in Polish companies. In recent years, leasing has become a competitive long-term source as compared to the bank loans. Year after year, its importance in financing the investments in Polish companies is growing. In case of short-term financing, a bank loan is the second only to trade credits. Moreover, Polish companies are increasingly using franchising. Owing to Polish integration with the European Union, they can also be supported by EU funds. Factoring and debt securities have a marginal importance [Bednarz and Gostomski, 2006].

The primary criterion for creating the financial structure of the enterprise is the cost of used capital. The cost of foreign capital is interest and fees paid. The cost of equity is the return level on invested capital expected by the owners. The resultant cost of these elements is the weighted average cost of capital (WACC), which according to economic calculations must be minimized.

Liabilities are cheaper as capital for the company than equity. Therefore, minimizing WACC is possible by increasing the share of foreign capital in the financing sources. However, excessive debt can lead the company to loss of liquidity, and consequently to the bankruptcy. In this context, the management of the company's financial structure is becoming a difficult task, depending on many individualized factors [More: Jaworski, 2010; Bień, 2005; Ross, Westerfield and Jordan, 1998].

Section 5

Main Problems of the Working Capital Management

Investment decisions, and decisions on the construction of a financial structure, are usually made periodically. The frequency of making them depends on the nature of activity, and on the size of the enterprise. The third and last domain of financial management, namely, working capital management, involves decisions on an ongoing basis, every day. The prerequisites of these decisions are fundamental questions of short-term financial policy [Brigham, 1997]:

- 1) What level of cash on hand, and in the bank, should the company maintain, to cover due payments,
- 2) how much money can the company borrow from banks and suppliers, and
- 3) what amount of trade credit should be offered to customers?

There are two basic types of short-term financial policy [Jaworski, 2010; Ross, Westerfield and Jordan, 1998]:

- 1) Flexible policy – the company keeps high level of current assets relative to sales volume, and a low level of current liabilities in relation to other passive components of the balance sheet.
- 2) Restrictive policy – characterized by low levels of assets compared with a turnover and a high proportion of short-term foreign capital in financing sources.

The first one allows for rapid customer service, and thus theoretically, it is possible to sell at higher prices in return for favorable terms of payment and instant service. Adhering to a restrictive policy reduces not only the price, but also the possible volume of sales. It is directly related to the risk of not having enough goods in stock.

Both policies are the result of the management of two cost types [Ross, Westerfield and Jordan, 1998]:

- 1) Cost of maintenance of the current assets – this cost is related to keeping current assets especially in view of a flexible policy,
- 2) Cost of shortage of current assets – cost in the event of resignation from sale or need to lower prices especially in view of restrictive policies.

These costs depend on the level of the current assets. It is the manager's job to find an appropriate point at the total cost, where the sum reaches a minimum value. This relationship is illustrated in Diagram 4.

The shape and the cost level in case of the current asset shortage depend on the situation on offered goods and services' market, on the level of supply, prices and purchase alternatives. The line of maintenance costs depends on the price of capital needed to finance the assets (interest rates, competition in the credit market, etc.). Consequently, the policy of the current assets management relies on moving around the line of total costs, and finding the point of the CA. In this point the sum of costs related with current assets is the lowest.

The implementation of any policies mentioned results in the introduction of various strategies in the management of gross working capital [Jaworski, 2010]:

- 1) Conservative strategy
- 2) Aggressive strategy.

These strategies are a consequence of the need to maintain liquidity, that is the ability to discharge liabilities.

Conservative strategy means manipulating the structure of assets at a stable level of the current liabilities. It is expressed primarily in the maintaining of high levels of most liquid assets – cash and short-term securities. In practice, this translates into high level of immediate liquidity. The surplus of liquidity serves to eliminate spontaneous liabilities in case of lack of operating revenue. Keeping the surplus of liquidity may reflect negatively on potential profit, for example through excessive costs related to the maintaining of high levels of stocks and cash.

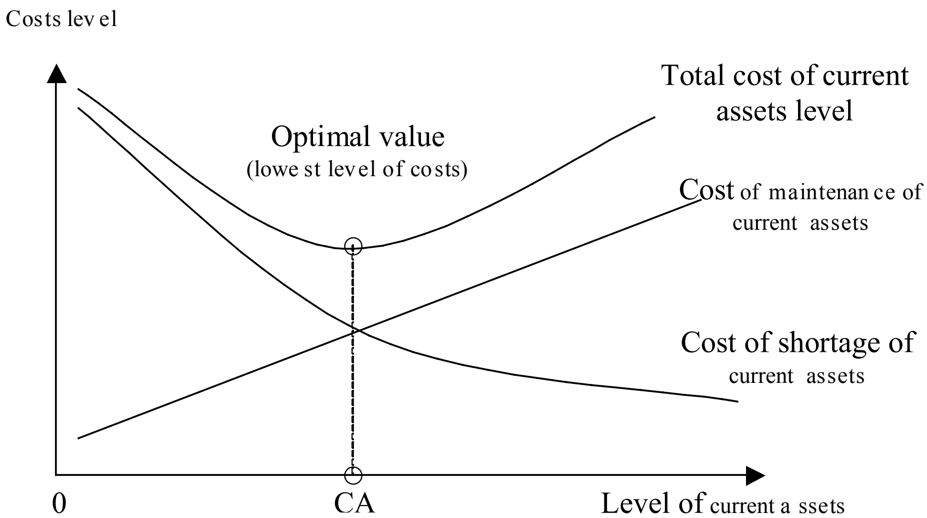

Diagram 4. Optimal level of current assets (Source: Ross, Westerfield and Jordan, 1998)

Aggressive strategy is the opposite to the conservative strategy. In the course of its implementation, it is appropriate to reduce liquid assets, which translates into minimizing the value of immediate liquidity. In the most extreme version of this strategy, receivables may also be reduced. This is a direct cause of increasing operating risk, which is a result of decreasing the current assets. The basis for the effectiveness of such activities is high profitability of fixed assets and higher rates of the return on invested capital.

CONCLUSIONS

Financial management is an important part of the company's management. It involves making decisions on the acquisition and investment of cash, taking into account all phenomena accompanying this activity. These decisions are taken in three main areas: creating a structure of assets and liabilities, and fixing levels and circulation speeds of the current assets. This appears in the context of achieving three key financial targets of the company: maximizing profit, generating free cash flow and increasing the value of the company

The main system providing information useful for financial decision making is the accounting system. Accounting tools allow the measurement of basic financial categories (assets and liabilities, revenues and expenses, and also inflows and expenditures). Thus, the proper control of decision-making, the planning of future activities and also the organizing and monitoring ongoing financial processes are made possible.

As shown in the article, multi-direction and multi-aspect charcter of corporate financial management makes the activity not an easy task. It requires considerable familiarity with the company, and with the specifics of the development of the financial flows, in addition to the use of sophisticated planning techniques and the control of financial flows. For this reason, an addoption of a scientific approach to these issues seems necessary.

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